

Internal Revenue Service

memorandum

WHEARD CC:TL:TS

TL-N-7917-89

date: SEP 25 1989

to: District Counsel, Houston
Attn: Janet Balboni

SW:HOU

from: Assistant Chief Counsel (Tax Litigation)

CC:TL

subject: Statute Of Limitations/Bankruptcy

This memorandum is in response to your request dated June 21, 1989.

ISSUES

1. What are the applicable statutes of limitations for partnership items which have converted to nonpartnership items by virtue of a partner filing for bankruptcy?
2. What are the applicable provisions which will operate to extend or suspend the above statutes of limitations?

CONCLUSIONS

1. It is Service position that partnership items which have converted to nonpartnership items by reason of bankruptcy must be assessed within the one year period provided by section 6229(f). If assessment is barred by the bankruptcy stay provision of 11 U.S.C. § 362(a), a notice of deficiency must be issued within the one year period of section 6229(f) in order to suspend the running of the period for assessment. Generally, we are unwilling to defend the validity of notices of deficiency issued after the period under section 6229(f) has expired but which are issued within the period provided by section 6501.

However, under certain limited circumstances, such as when the statute of limitations would expire less than a year after the partner's return was due to be filed, we will consider asserting the longer period of assessment under section 6501(a) on a case by case basis. Authorization must be secured from the national office to assert the applicability of section 6501.

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2. The suspension provisions which apply to section 6229(f) when a taxpayer files for bankruptcy, and a notice of deficiency is issued for the converted items, are sections 6503(a), 6213(a) and 6213(f)(1). Section 6503(i) does not apply to section 6229(f).

3. In situations where the national office authorizes the use of section 6501(a), the suspension provisions of section 6501(a), including section 6503(i) will apply.

DISCUSSION

I. BANKRUPTCY OF A PARTNER CONVERTS PARTNERSHIP ITEMS TO NONPARTNERSHIP ITEMS

Section 6231(b)(1)(D) provides:

(b) Items Cease To Be Partnership Items in Certain Cases.-

(1) **In General.**-For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date-

. . .

(D) such change occurs .
. . under subsection (c)
of this section.

Section 6231(c) provides:

(c) Regulations with Respect to Certain Special Enforcement Areas.-

(1) **Applicability of subsection.**-
This subsection applies in the
case of-

. . .

(E) other areas that the Secretary determines by regulation to present special enforcement considerations. (emphasis supplied)

(2) Items may be treated as nonpartnership items.- To the extent that the Secretary determines and provides by regulations that to treat items as partnership items will interfere with the effective and efficient enforcement of this title in any case described in paragraph (1), such items shall be treated as nonpartnership items for purposes of this subchapter. (emphasis supplied)

Temp. Treas. Reg. § 301.6231(c)-7T(a), which was promulgated pursuant to the above statutory authority, provides:

Bankruptcy. The treatment of items as partnership items with respect to a partner named as a debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership items as of the date the petition naming the partner as debtor is filed in bankruptcy.

Thus, when a partner files a petition in bankruptcy, his partnership items convert to nonpartnership items for all years over which the Service could file a claim for income taxes. On the other hand, the bankruptcy of the partnership as an entity will not convert the partnership items of individual partners to nonpartnership items since the individual partners will not be subject to a claim for income tax due in the partnership bankruptcy proceeding. See In re Brandt-Airflex Corp., 843 F.2d 90, 95-96 (2d Cir. 1988). 1/

1/ Additionally, a bankruptcy proceeding with respect to the partnership will not operate to stay a TEFRA partnership proceeding since the TEFRA proceeding is with respect to individual non-debtor partners and not with respect to the debtor partnership as an entity.

II. CONVERTED PARTNERSHIP AND AFFECTED ITEMS ARE SUBJECT TO A ONE YEAR PERIOD FOR ASSESSMENT UNDER SECTION 6229(f)

The issue at this point is what statute of limitations applies to the converted partnership items of a partner who has filed for bankruptcy in his individual capacity.

Section 6229(f) provides:

(f) **Items Becoming Nonpartnership Items.**--If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. The period described in the preceding sentence (including any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner.
(emphasis supplied)

Section 6229(f) states that the period for assessing converted partnership and affected items "shall not expire before" one year after the conversion. The "shall not expire" language raises a question whether we have the longer of the section 6229(f) one year period or the time remaining on the section 6501 statute for nonpartnership items. We believe sections 6229 and 6501 are separate statutes. We, generally, will not defend the timeliness of notices issued after the period under section 6229(f) has expired, even if the period under section 6501 remained open at the time of issuance of the notice of deficiency.

One potential situation in which we may be willing to argue the application of section 6501 to converted partnership items is when the period under section 6229(f) will expire less than a year after the bankrupt partner's return for the items in question is due. For example: a partner for the 1984 taxable year files for bankruptcy on January 1, 1985, thus converting his partnership items to nonpartnership items. On April 1, 1985, he is discharged in bankruptcy. The partner files for an automatic extension for filing his return and then files his return for the 1984 taxable year on September 15, 1985. The period for

assessment under section 6229(f) would expire on January 1, 1986, three and one-half months after the return is filed.

In regard to concession, note that the timely issuance of a notice of deficiency is not a jurisdictional issue but is an affirmative defense. Badger Materials, Inc. v. Commissioner, 40 T.C. 1061, 1063 (1963). Thus, rather than filing a motion to dismiss, the timeliness of a notice should be conceded in the answer and a stipulated decision document should be filed reflecting no deficiency. I.R.C. § 7459(e). Alternatively, a motion for summary judgment by petitioner should be granted. Barbados # 7, Ltd., v. Commissioner, 92 T.C. 804 (1989)

II. SUSPENSION PROVISIONS

A. Section 6229(f)

A significant problem with the one year period provided by section 6229(f) is that the Service frequently does not discover the filing for bankruptcy until more than one year after the filing. This problem is further exacerbated by the inapplicability of section 6503(i) to section 6229(f). Section 6503(i) does not apply to section 6229(f) since section 6503(i) by its own terms only applies to sections 6501 and 6502.

Section 6503(i) provides:

The running of the period of limitations provided in section 6501 or 6502 on the making of assessments or collection shall, in a case under title 11 of the United States Code, be suspended for the period during which the Secretary is prohibited by reason of such case from making the assessment or from collecting and-

- (1) for assessment, 60 days thereafter, and
- (2) for collection, 6 months thereafter.
(emphasis supplied)

Since the filing for bankruptcy will not suspend the period for assessment under section 6229(f), a notice of deficiency must be issued within one year of the filing for bankruptcy in order to suspend the period for assessment. The issuance of a notice of deficiency under section 6212(a) is authorized pursuant to section 6230(a)(2)(A) for items which have converted to

nonpartnership items by reason of bankruptcy.^{2/} The issuance of such a notice will suspend the statute of limitations under section 6229(f) pursuant to section 6503(a). Section 6503(a) provides, in this regard, as follows:

(a) Issuance of Statutory Notice of Deficiency.-

(1) General rule.-The running of the period of limitations provided in . . . section 6229, but only with respect to a deficiency described in section 6230(a)(2)(A) . . . shall (after the mailing of a notice under section 6212(a)) be suspended for the period during which the Secretary is prohibited from making the assessment . . . and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final . . . and for 60 days thereafter. (emphasis supplied)

^{2/} Section 6230(a)(2)(A) provides:

(2) Deficiency proceedings to apply in certain cases.-

(A) Subchapter B shall apply to any deficiency attributable to-

. . .

(ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) and are described in section 6231(e)(1)(B). (emphasis supplied)

Section 6231(e)(1)(B) refers to proceedings with respect to items which have become nonpartnership items by reason of one or more of the events listed in section 6231(b). Section 6231(b)(1)(D) includes conversion to nonpartnership items under special enforcement regulations promulgated pursuant to section 6231(c). Temp. Treas. Reg. § 301.6231(c)-7T, which converts partnership items to nonpartnership items when a person files for bankruptcy, was promulgated pursuant to section 6231(c)(1)(E). Thus, section 6230(a)(2)(A) authorizes the use of deficiency proceedings with respect to items converted to nonpartnership items by reason of bankruptcy.

Note that, while 11 U.S.C. § 362(a) prohibits the filing of a petition with respect to a notice of deficiency once a bankruptcy proceeding has been commenced, it does not prohibit the issuance of the notice of deficiency itself. 11 U.S.C. § 362(b)(9).

Once a notice of deficiency is issued, section 6229(f) will be suspended by sections 6503(a), 6213(a) and 6213(f)(1). Section 6503(a) provides that the statutory period for assessment shall be suspended after the mailing of a notice of deficiency for the period the "Secretary is prohibited from making the assessment . . . and for 60 days thereafter." Section 6213(a) prohibits the Secretary from making the assessment during the 90 or 150 day petition period (and if a petition is filed in Tax Court, until the decision of the Tax Court has become final). In cases of bankruptcy of the taxpayer, however, the 90 or 150 day petition period is "suspended for the period during which the debtor is prohibited by reason of such case from filing a petition in the Tax Court with respect to such deficiency, and for 60 days thereafter." I.R.C. § 6213(f)(1).

Thus, if a notice of deficiency is issued within the one year period of section 6229(f), the statute of limitations may be computed from the date of issuance adding:

(1) the remaining period of the bankruptcy stay after the issuance of the notice of deficiency plus 60 days under section 6213(f)(1)^{3/}; plus,

(2) the 90 or 150 day petition period of section 6213(a) (plus, if a petition is filed in Tax Court, the time until the decision of the Tax Court has become final, subtracting the petition period left when the petition is filed, i.e., no tacking of remaining petition period); plus,

(3) the 60 day suspension period of section 6503(a).
See LGM, GL-28 (Sept. 20, 1988).

In addition, the unexpired portion of the one year period under section 6229(f) remaining at the time the notice is issued may be "tacked on" to the end of the above "suspension" periods.

^{3/} The automatic stay under 11 U.S.C. § 362(a)(8) is the operative provision prohibiting the commencement of Tax Court proceedings, including the filing of petitions with the Tax Court. The debtor/taxpayer is permitted to petition the Tax Court after the Bankruptcy Court lifts the stay for such a petition, pursuant to a motion, or the stay expires pursuant to section 11 U.S.C. § 362(c)(2). See Thompson v. Commissioner, 84 T.C. 645 (1985). See also LGM, GL-33 (May 7, 1987).

However, since there is a split in the circuits as to whether a tack on period exists under similar statutes, we strongly recommend that assessment occur or a notice of deficiency be issued prior to the time the tack on period begins. See Hoosac Mills Corp. v. Commissioner, 75 F.2d 462 (1st Cir. 1935) (notwithstanding "suspension" of section 6501 by stay provision, no tack on period exists). Contra Ramirez v. United States, 538 F.2d 888 (Ct. Cl. 1976); Clark v. Commissioner, 90 T.C. 68, 71 (1988).

Note that the period under section 6229(f), pursuant to the last sentence of that section, may also be extended by agreement between the Commissioner and the affected partner. As a matter of policy, however, the Examination Division has decided not to implement this provision, although the Appeals Division will extend this period in appropriate circumstances.

In summary, assessments must be made or a notice of deficiency issued within one year of the time a partner files a petition in bankruptcy or is otherwise named as a debtor in a bankruptcy proceeding. Once a notice of deficiency is issued, section 6229(f) will be suspended by sections 6503(a), 6213(a) and 6213(f)(1), but not by section 6503(i). We will generally concede the untimeliness of notices issued after the one year period of section 6229(f), even if they are issued while the period for assessing nonpartnership items under section 6501 is still open.

B. SECTION 6501

In those cases where section 6229(f) will expire less than a year after the partnership and partner file their returns we may be willing to assert the application of section 6501 on a case by case basis. These situations will require coordination with the national office. The normal suspension periods would generally apply including section 6503(i).

If an extension, such as a Form 872-A, is executed before partnership items convert to nonpartnership items, the extension will not apply to the converted items unless the extension form expressly refers to partnership items. I.R.C. § 6229(b)(2). If, after conversion, an extension of section 6501 is executed, the extension should apply to the converted items. A specific reference to partnership items should not be necessary in this second scenario because the taxpayer is no longer treated as having partnership items.

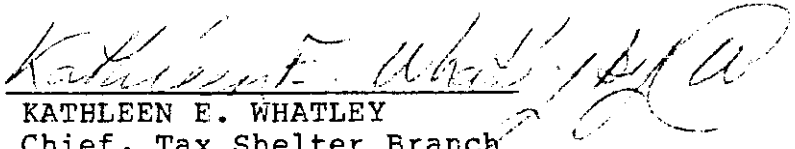
In summary, for planning purposes the only statute of limitations that will apply to converted partnership items is section 6229(f). Only in limited circumstances will we be willing to assert section 6501 as an alternative. Such a circumstance may be where section 6229(f) will expire less than a

year after the partnership and partner returns are due, and we do not discover the conversion until after section 6229(f) has expired.

Please refer any questions to Bill Heard at FTS 566-3233.

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By:


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